

REPORT OF
FINANCIAL EXAMINATION

GATEWAY INSURANCE COMPANY

As Of
December 31, 2004



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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May 5, 2005
St. Louis, Missouri

Honorable Kevin M. McCarty, Commissioner
Office of Insurance Regulation
Florida Department of Insurance
Chairman, Financial Condition (E) Committee, NAIC

Honorable Jorge Gomez, Commissioner
Office of the Commissioner of Insurance
State of Wisconsin
Secretary, Midwestern Zone, NAIC

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Dear Sirs:

In accordance with your financial examination warrant, a full scope financial examination has been made of the records, affairs and financial condition of

Gateway Insurance Company

also referred to as "Gateway" or as the "Company." The Company's administrative office is at 1401 S. Brentwood Boulevard, Suite 1000; St. Louis, MO 63144, telephone number (314) 373-3333. This examination began on February 14, 2005, and concluded on May 5, 2005.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Gateway Insurance Company was as of December 31, 2001, and was conducted by examiners from the state of Missouri, representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC).

The current full scope association financial examination covers the period from January 1, 2002, to December 31, 2004, and was conducted by examiners from the state of

Missouri representing the Midwestern Zone of the NAIC with no other zones participating. Reserves and related actuarial items were reviewed by Jon W. Michelson, FCAS, MAAA, of the firm, Expert Actuarial Services, LLC, pursuant to a contract with the Missouri Department of Insurance.

This examination also included material transactions and/or events occurring after December 31, 2004.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the state of Missouri prevailed.

The Company's independent auditors, Brown Smith Wallace, LLC conducted their audit concurrently with our financial examination. However, there were some work papers that were made available to the examiners. Standard examination procedures were modified as deemed appropriate under the circumstances.

Comments – Previous Examination

There were no comments or recommendations in the previous examination report dated December 31, 2001.

HISTORY

General

The Company was originally chartered as a mutual insurance company on August 28, 1946 under the title Group Casualty Underwriters, Incorporated and was dormant during the

years 1948 to 1955. On November 15, 1955, a reorganization plan was adopted whereby the former principles of Laclede Cab Company obtained management control for the primary purpose of having a permanent vehicle to provide insurance coverage for Laclede Cab Company. For the next two decades the Company became the primary insurer of taxi companies in the St. Louis area. On December 15, 1955, the articles of incorporation were amended changing the name of the Company to Group Underwriters Mutual Insurance Company.

In March 1986, both the policyholders and the board of directors of the Company unanimously approved a demutualization plan. On December 1, 1986, Group Underwriters Mutual Insurance Company was converted to a stock company and merged into Group Casualty Underwriters Insurance Company. Group Casualty Underwriters Insurance Company was incorporated on May 21, 1986, and on December 1, 1986, received its Certificate of Authority to operate under the provisions of Chapter 379 RSMo *Insurance Other than Life*.

Effective August 1, 1991, the Company adopted its current name, Gateway Insurance Company.

On August 29, 2000, Mid-American General Agency, Inc., the owner of 100% of the stock of Gateway Insurance Company purchased all the outstanding stock of CIE Service Corporation for \$2,500,000. CIE Service Corporation was the Attorney-In-Fact for Casualty Indemnity Exchange a Missouri domiciled insurance exchange. CIE Service Corporation changed its name to Camelot Services, Inc. and Casualty Indemnity Exchange changed its name to Camelot Insurance Underwriters.

On September 12, 2001, Camelot Insurance Underwriters merged with the Company.

In December 2001, Camelot Services, Inc. merged with Mid-American General Agency, Inc.

In January 2002, Mid-American General Agency, Inc. changed its name to Camelot Services, Inc.

Capital Stock

The Company is authorized to issue 50,000 shares of common stock with a par value of \$100 per share. During August 2003, Camelot Services, Inc., the parent, contributed \$6,000,000 to Gateway Insurance Company. One million dollars of the contribution purchased 10,000 additional shares of Gateway's \$100 par value common stock. The remaining five million dollars increased the Company's Gross Paid In and Contributed Surplus. As of December 31, 2004, 30,000 shares were issued and outstanding, resulting in Common Capital Stock of \$3,000,000 and Gross Paid In and Contributed Surplus of \$8,874,370.

Dividends

The Company has declared and paid dividends to the stockholder as follows:

	<u>Cash</u>
Through December 31, 2001	\$ 780,000
2002	150,000
2003	250,000
2004	<u>500,000</u>
Total	<u>\$ 1,680,000</u>

Management

The Board of Directors consists of nine members duly elected at an annual meeting of the stockholder as authorized by the Company's Articles of Incorporation. The directors duly elected and serving as of December 31, 2004, were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
Barry T. Cervantes St. Louis, MO	Gateway Insurance Company, Chairman and President
Daniel J. Boxell O'Fallon, MO	Gateway Insurance Company, Chief Operating Officer
Richard E. Clift Chesterfield, MO	Bowersox Insurance Agency, President
Ted Hume St. Louis, MO	Alliance United Insurance Company, Chairman
John T. Murphy, Jr. Ladue, MO	Attorney at Law, Retired
Gerhard J. Petzall Ballwin, MO	Guilfoil, Petzall & Shoemake, Attorneys at Law, Managing Member
Oscar H. Straub St. Louis, MO	Motor Carrier Insurers, Chairman
Steven R. Straub St. Louis, MO	Motor Carrier Insurers, President
John J. Temporiti St. Louis, MO	St. Louis County Economic Council, Attorney at Law

Committees appointed by the Board of Directors as of December 31, 2004, were as follows:

<u>Executive</u>	<u>Finance</u>	<u>Audit</u>	<u>Claims/Legal</u>
Barry T. Cervantes *	Daniel J. Boxell *	Ted Hume *	Gerhard J. Petzall *
Steven R. Straub	Barry T. Cervantes	Daniel J. Boxell	Sandra K. Lehde
	Serena M. Lintker	Richard E. Clift	John T. Murphy, Jr.

* Indicates Committee Chairman

The officers elected and serving as of December 31, 2004, were as follows:

<u>Name</u>	<u>Office</u>
Barry T. Cervantes	Chairman and President
Daniel J. Boxell	Chief Operating Officer, Secretary and Treasurer
Alvin H. Adelman	Vice President Sales and Marketing
Richard E. Kleinschmidt	Vice President Commercial Automobile
Sandra K. Lehde	Vice President Claims/Litigation
Serena M. Lintker	Vice President Finance
Theresa Thorburg	Vice President Administration, Assistant Secretary

Conflict of Interest

Company policy is that Conflict of Interest Statements are to be executed annually by directors and officers of the Company. During 2003, statements were not received from the officers of the Company. This oversight was brought to the Company's attention. The Company was able to demonstrate current compliance with its policy by providing executed Conflict of Interest Statements for all directors and officers for 2005. For those Statements reviewed, no conflicts were noticed.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws of the Company. Neither the Articles of Incorporation nor the Bylaws were amended during the period being examined.

The minutes of the meetings of the stockholder and board of directors were reviewed for the period under examination. The minutes appeared to properly document approval of applicable corporate events and transactions. It was noted that the examination report as of December 31, 2001, was reviewed and accepted by the Company's board of directors on March 13, 2003.

Acquisitions, Mergers and Major Corporate Events

The Company entered into an agreement with Pacific Northwest Insurance, LLC (PNI) in early 2003 to underwrite a book of trucking liability and hospitality liability coverage with the proviso that PNI would provide assets to protect the Company's surplus. The liability coverage provided limits of up to one million dollars. Because PNI did not provide the assets as agreed upon and the fact that the Company was unable to obtain reinsurance for this business, the Company was exposed to a net retained risk on any one policy of one million dollars, which rendered the Company in violation of 20 CSR 200-1.010(4), *Financial Condition of Insurance Companies*, which mandates that any one risk exposure shall be no more than 10% of policyholder surplus. The Company had written approximately \$10.4 million in premiums when the Missouri Department of Insurance issued a cease and desist order on the business. As of the end of 2004, Gateway had suffered a total underwriting loss of \$6.08 million on this business. Until the statutes of limitations run out in the relevant states there is still a risk of exposure to the one million dollar limit. Gateway has won a judgment against PNI for the financial harm inflicted on the Company.

Currently the Company is submitting financial reports to the Missouri Department of Insurance on a monthly basis.

Surplus Debentures

None.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

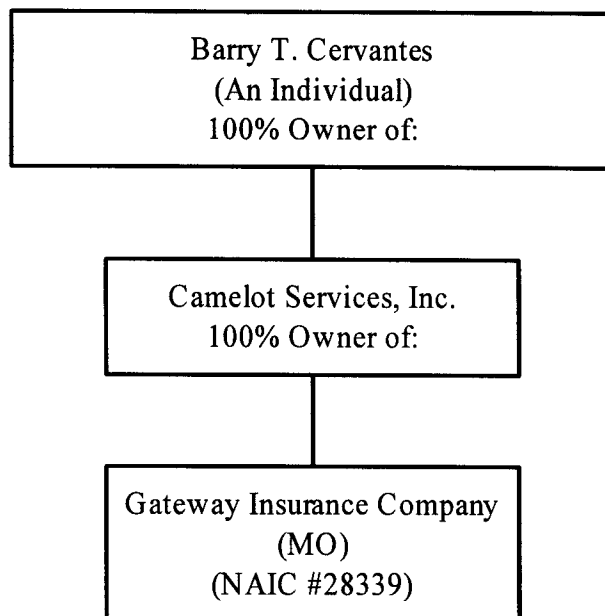
The Company is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo *Definitions*. The ultimate controlling person is Barry T. Cervantes, an individual. Mr. Cervantes owns 100% of the common stock Camelot Services, Inc., which owns 100% of the Company. Camelot Services, Inc. has 500 shares of common stock (\$1 par value) issued and outstanding.

Camelot Services, Inc. also has 2,640 shares of 5% cumulative redeemable preferred stock (\$1,000 par value) issued and outstanding. Frontenac Financial Group, Inc. owns all the outstanding preferred stock.

Barry T. Cervantes pledged the stock of Camelot Services, Inc., as well as the common stock of the Company, as collateral for bank loans with outstanding balances of approximately \$3.7 million on December 31, 2004. Barry T. Cervantes has pledged the common stock of Camelot Services, Inc. and Gateway Insurance Company as collateral for bank loans with outstanding balances of \$6 million as of December 31, 2004. All loans have been issued by the Bank of Washington.

Organizational Chart

The following organizational chart depicts the insurance holding company system as reflected in the Company's annual registration statement, dated April 13, 2004, filed with the Missouri Department of Insurance to meet the requirements of Section 382.100 RSMo *Registration*.



Intercompany Transactions

During the period under examination the Company was party to one inter-company agreement as follows:

Type: Federal Income Tax Allocation Agreement

Parties: Gateway Insurance Company and Camelot Services, Inc.

Effective: September 10, 1993

Terms: Each party agreed to join in the filing of a consolidated federal income tax return for calendar year 1993 and all years thereafter. Pursuant to this agreement, the consolidated tax liability for each year will be apportioned among the members of the consolidated group in accordance with the ratio, which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income. This agreement also establishes methods for the purpose of reimbursing the parent for the payment of the tax liability, compensating for the use of losses or tax credits and providing for the allocation and payment of any refund arising from a carry back or carry forward of losses or tax credits.

This agreement was filed with the Missouri Department of Insurance and was not disapproved.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a crime policy purchased by Camelot Services, Inc., the Company's immediate parent in the holding company system. This policy provides fidelity coverage with a limit of \$500,000 and a deductible of \$5,000. The coverage limit meets the minimum limits suggested under the NAIC guidelines.

The Company also has the following types of insurance protection: property, general liability, automobile, umbrella liability, workers' compensation, computer systems, directors and officers, employment practices and fiduciary liability. It appears that Camelot Services, Inc. has adequate coverage for protection of its assets.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company provides typical employee benefits including:

- Group life, medical and dental coverage
- Short and long term disability
- Flex days for personal, vacation or sick leave
- Holiday pay
- Tuition aid

All active full-time employees of the Company who are at least twenty-one years old and have completed one year of service are eligible to participate in a 401(k) retirement savings plan sponsored by the Company.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2004, as reflected below, were deemed sufficient in par and market value to meet the deposit requirement for the state of Missouri in accordance with Section 379.098(1) RSMo *Securities Deposits*.

<u>TYPE OF SECURITY</u>	<u>PAR VALUE</u>	<u>MARKET VALUE</u>	<u>STATEMENT VALUE</u>
U.S. Treasury	\$ 800,000	\$ 821,280	\$ 806,332
U.S. Treasury	1,250,000	1,260,550	1,230,347
U.S. Treasury	500,000	536,290	539,655
U.S. Treasury	200,000	193,804	188,527
Total	\$ 2,750,000	\$ 2,811,924	\$ 2,764,861

Deposits with Other States

The Company also has funds on deposit with various other states. Those funds on deposit as of December 31, 2004, were as follows:

<u>STATE</u>	<u>TYPE OF SECURITY</u>	<u>PAR VALUE</u>	<u>MARKET VALUE</u>	<u>STATEMENT VALUE</u>
Arizona	U.S. Treasury Note	\$500,000	\$536,290	\$539,655
Arkansas	U.S. Treasury Note	300,000	321,960	325,247
Georgia	U.S. Treasury Note	50,000	50,422	49,214
Louisiana	U.S. Treasury Note	110,000	112,536	110,008
Nevada	GE Capital Corp.	300,000	307,763	320,200
New Mexico	U.S. Treasury Note	350,000	375,403	377,759
South Carolina	U.S. Treasury Notes	200,000	201,909	197,143
Total		\$1,810,000	\$1,906,283	\$1,919,226

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed in Missouri under Chapter 379 RSMo *Insurance other than life*, to write property, liability, fidelity and surety, and miscellaneous insurance, though the Company has never written any fidelity and surety business. The Company is also licensed in the District of Columbia and the following states:

Alabama	Georgia	Louisiana	North Dakota	Tennessee
Alaska	Idaho	Maryland	Ohio	Texas
Arizona	Illinois	Mississippi	Oklahoma	Utah
Arkansas	Indiana	Montana	Oregon	West Virginia
Colorado	Iowa	Nebraska	Pennsylvania	Wisconsin
Delaware	Kansas	Nevada	South Carolina	Wyoming
Florida	Kentucky	New Mexico	South Dakota	

The Company writes in three niches as follows:

Commercial Auto specializing in taxicabs, limousines, black sedans, airport limousine services, shuttles, and non-emergency medical transportation services, located in targeted secondary markets throughout the states in which it presently operates.

Non-Standard Private Passenger Auto targets the higher risk component of the non-standard private passenger automobile liability and physical damage insurance market. The Company markets this product in Missouri and Kansas. Policies are generally written for the compulsory minimum limits.

Specialty Programs provide managing general agencies (MGAs) the ability to offer non-standard private passenger auto policies underwritten by Gateway Insurance Company. Under Gateway's supervision, the MGA administers its own underwriting, claims adjustment and support functions, thereby maintaining direct control of its business. Only ten per cent of the premiums from this business is retained, with the rest being reinsured. All these arrangements are currently in run-off status.

All business is written through independent agents. For private passenger automobile liability, there are 256 active agents in Kansas and 688 active agents in Missouri. The commercial business is written through 286 active agents.

Policy Forms & Underwriting; Advertising & Sales Materials and Treatment of Policyholders

The Missouri Department of Insurance has a Market Conduct staff that performs a review of these issues and generates a separate market conduct report. The most recent Missouri Market Conduct Examination was as of June 30, 2003 covering the period from July 1, 2001 through June 30, 2002. The Company could have been fined for various violations, but due to the Company's financial position at the time, no fine was levied.

The Company has a complaint system in place and appears to handle complaints in a timely manner.

REINSURANCE

The Company's premiums on a direct written and ceded basis for the current examination period were as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Direct Business	\$21,090,094	\$38,924,960	\$43,245,476
Reinsurance Ceded	<u>(1,839,436)</u>	<u>(6,930,855)</u>	<u>(20,154,352)</u>
Net Premiums	<u>\$19,250,658</u>	<u>\$31,994,105</u>	<u>\$23,091,124</u>

Assumed

The Company assumes a very small amount of reinsurance from mandatory pools.

Ceded

During the period under examination the Company's main reinsurance agreement was with American Re-Insurance Company of New Jersey. That contract was in effect from January

1, 2002 to January 1, 2005 and was a casualty excess of loss agreement. The reinsurer was responsible for 100% of the losses in excess of \$100,000 but not more than \$400,000 net loss per occurrence. This contract covered commercial automobile liability including bodily injury, property damage, medical payments, uninsured motorists and underinsured motorists liability. This reinsurance agreement accounted for over 66% of all reinsurance premiums ceded in 2004.

Another major reinsurer of the Company during the period under examination was General Reinsurance Company. All agreements with General Reinsurance Company are facultative excess of loss agreements after the first \$500,000. The coverage also is for commercial automobile liability. Beginning in 2005, Gateway Insurance Company will retain the first \$200,000 of liability with American Re-Insurance Company reinsuring 100% of the loss excess of \$200,000 to one million dollars. The General Reinsurance Company facultative agreements will then be in excess of one million dollars.

Besides the two major agreements discussed above, the Company has various agreements in run-off relative to fronting arrangements for the **Specialty Programs** made in Florida, Georgia and West Virginia. Those are all quota share agreements with the Company retaining 0% - 10% of the premiums and losses and ceding 90% - 100% of the premiums and losses.

We reviewed all of the Company's reinsurance agreements and they all appear to transfer risk and contain the standard clauses. The Company has no reinsurance for its private passenger automobile business as the liability coverage meets statutory requirements and thus has low limits. Nor was there any reinsurance in place for either the Company's trucking business or the Company's hospitality business. The Company stopped writing both trucking and hospitality business in July 2004.

ACCOUNTS AND RECORDS

The Company's financial statements are audited annually by the independent accounting firm, Brown Smith Wallace, LLC. Their audit was conducted concurrently with our financial examination. They shared some of their work papers with us and those work papers were used in the course of this examination as deemed appropriate.

The Information Systems Examination Specialist with the Missouri Department of Insurance completed an electronic data processing controls audit and concluded that systems controls appear reasonable for a Company of this size.

Reserves and related actuarial items are reviewed and certified by Wayne D. Holdredge, ACAS, MAAA, and Jeffrey D. Kimble, ACAS, of Towers Perrin Tillinghast. Consulting actuary, Jon W. Michelson FCAS, MAAA, of Expert Actuarial Services, LLC, was retained by the Missouri Department of Insurance to review the adequacy of losses and other related liabilities.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2004, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the “Notes to the Financial Statements” which follow the financial statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been additional differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements.” These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only noted in the work papers for each individual annual statement item.

ASSETS

	<u>Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 23,472,688		\$ 23,472,688
Common stock	1,755,154		1,755,154
Cash and short term investments	4,926,948		4,926,948
Notes receivable	2,866,388	2,866,388	-
Investment income due and accrued	198,474	400	198,074
Uncollected premiums and agents' balances in course of collection	1,371,458	162,446	1,209,012
Deferred premiums, agents' balances and installments booked but deferred	6,176,853		6,176,853
Amounts recoverable from reinsurers	304,652		304,652
Net deferred tax asset	2,409,363	1,772,647	636,716
Electronic data processing equipment	31,464		31,464
Equities and deposits in pools and associations	4,155		4,155
State premium tax recoverable	<u>316,856</u>	<u>-</u>	<u>316,856</u>
Total Assets	<u>\$ 43,834,453</u>	<u>\$ 4,801,881</u>	<u>\$ 39,032,572</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$ 17,370,622
Loss adjustment expenses		2,539,489
Commissions payable, contingent commissions and other similar charges		942,172
Other expenses		414,574
Taxes, licenses and fees due or accrued		120,625
Unearned premiums		8,717,398
Ceded reinsurance premiums payable		151,371
Amounts withheld or retained by company for account of others	Note 1	272,954
Remittances and items not allocated		
Drafts outstanding	Note 1	<u>59,451</u>
Total Liabilities		\$ 30,588,656
Common capital stock		3,000,000
Gross paid in and contributed surplus		8,874,370
Unassigned funds (surplus)		<u>(3,430,454)</u>
Surplus as regards policyholders		<u>\$ 8,443,916</u>
Total Liabilities and Surplus		<u>\$ 39,032,572</u>

STATEMENT OF INCOME

Premiums earned	\$ 21,253,745
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DEDUCTIONS

Loss incurred	12,560,330
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Loss expense incurred	2,748,265
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Other underwriting expenses incurred	<u>7,137,278</u>
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Total underwriting deductions	22,445,873
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Net underwriting gain or loss	(1,192,128)
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INVESTMENT INCOME

Net investment income earned	1,093,269
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Net realized capital gains/(losses)	<u>144,316</u>
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Net investment gain or (loss)	1,237,585
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OTHER INCOME

Aggregate write-ins for miscellaneous income	<u>8,116</u>
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Total other income	8,116
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Net income before dividends to policyholders and federal & foreign taxes	53,573
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Dividends to policyholders	-
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Net income after dividends to policyholders, before federal & foreign taxes	53,573
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Federal and foreign income taxes incurred	
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Net income	<u>\$ 53,573</u>
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NOTES TO FINANCIAL STATEMENTS

Note 1	Amounts withheld or retained by company for account of others	\$272,954
	Drafts outstanding	59,451

There is a reclassification of \$32,280 between Drafts Outstanding and Amounts Withheld or Retained by Company for Account of Others. This amount represents drafts that have been outstanding for over 180 days, and by Company standards should be included in their unclaimed property account.

EXAMINATION CHANGES

Total Surplus Per Annual Statement:

Common capital stock	\$ 3,000,000
Gross paid in and contributed surplus	8,874,370
Unassigned surplus	<u>(3,430,454)</u>

Surplus as Regards Policyholders **\$ 8,443,916**

Increase In Surplus	Decrease In Surplus
------------------------	------------------------

Assets:

<u>-</u>	<u>-</u>
----------	----------

Liabilities:

Amounts withheld or retained by Company
for account of others

Drafts outstanding

32,280	32,280		Note 1
<u>32,280</u>	<u>-</u>		Note 1

Total **\$ 32,280** **\$ 32,280**

Net Change **-**

Total Surplus Per Examination Report:

Common capital stock	\$ 3,000,000
Gross paid in and contributed surplus	8,874,370
Unassigned surplus	<u>(3,430,454)</u>

Surplus as Regards Policyholders **\$ 8,443,916**

GENERAL COMMENTS AND/OR RECOMMENDATIONS

None.

SUBSEQUENT EVENTS

None.

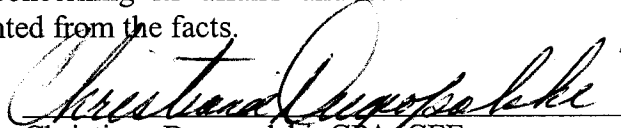
ACKNOWLEDGMENT

The assistance and cooperation extended by various employees of Gateway Insurance Company during the course of this examination are hereby acknowledged and appreciated. In addition to the undersigned, Karen J. Milster, CPA, CFE; and Andrew T. Balas, AES, CFE, CPA; examiners for the Missouri Department of Insurance participated in this examination.

VERIFICATION

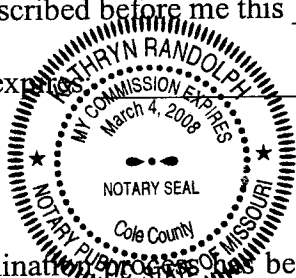
State of Missouri)
) ss
County of Cole)

I, Christiana Dugopolski, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiner finds reasonably warranted from the facts.


Christiana Dugopolski, CPA, CFE
Examiner-in-Charge
Missouri Department of Insurance
Midwestern Zone, NAIC

Sworn to and subscribed before me this 26 day of May, 2005.


My commission expires _____




Kathryn Randolph
Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting work papers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.


J. Douglas Conley, CFE, FLMI, CIE, AIAF, ARE
Audit Manager - St. Louis
Missouri Department of Insurance
Midwestern Zone, NAIC